Alternatives to the Gift and Estate Tax

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ALTERNATIVES TO THE GIFT AND ESTATE TAX

DAVID G. DUFF*

Abstract: Following the near-death experience of the federal gift and estate tax in 2010, the hundredth anniversary of the tax represents an ideal moment to reflect on the role of this tax and whether an alternative approach might be more desirable and sustainable. This Article examines four prominent alternatives to the current tax: an annual wealth tax, taxing unrealized gains at death, including gifts and inheritances in income, and a lifetime accessions tax that would apply to the cumulative value of gifts and inheritances received by individuals over their lifetimes. In order to assess these alternatives, the Article reconsiders the reasons for taxing wealth transfers, arguing that the primary purpose of a wealth transfer tax is not to raise revenue or enhance progressivity, but to regulate intergenerational transfers of wealth in order to reduce unearned concentrations of wealth and power and promote fair equality of opportunity. On this basis, it argues that a lifetime accessions tax is an attractive alternative to the current tax.

INTRODUCTION

As the current incarnation of the gift and estate tax approaches its centennial, it is an ideal time to reflect on its role and its prospects. Although the tax survived a near-death experience in 2010, its role in the federal tax system is significantly diminished from what it was only fifteen years ago—which was itself arguably diminished from what it was fifty years before that.1 Despite substantial increases in the tax-exempt threshold and significantly reduced revenues, the tax has managed to survive—at least for now. For advocates of wealth transfer taxation such as myself,2 this might be regarded as a major accomplishment, particularly given the intensive campaign that has

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been waged against the tax since the late 1980s, and the repeal of these taxes in several developed counties over the last several decades. Given this experience, one might wonder whether alternatives to the gift and estate tax might be more desirable, and perhaps more sustainable. Might it be better, for example, to replace infrequent taxes on intergenerational transfers of wealth with a more frequent tax applied to annual net wealth holdings? Should the federal government follow Canada’s example from forty years ago by abandoning gift and estate tax and taxing unrealized gains when property is transferred by gift or at death? Might it be better to include gifts and inheritances in income, as Henry Simons suggested eighty years ago, the Canadian Royal Commission on Taxation recommended in 1966, and others have proposed more recently? Or should the federal government retain a distinct wealth transfer tax, but apply it to recipients, rather than donors, in the form of a lifetime accessions tax on the cumulative value of gifts and inheritances received by individuals over the course of their lifetimes?

This Article considers each of these alternatives to the current gift and estate tax, arguing that a lifetime accessions tax best fulfills the primary purpose of a wealth transfer tax to reduce concentrations of inherited wealth, and would be easier to defend and justify than the existing gift and estate tax. Part I considers the reasons for taxing wealth transfers, arguing that the primary purpose of a tax on wealth transfers is neither to raise revenue nor to enhance the progressivity of the overall tax system, but to regulate intergenerational transfers of wealth in order to reduce unearned concentrations of wealth and power and ensure what John Rawls calls “fair equality of opportunity.” From this perspective, Part II considers four alternatives to the current gift and estate tax—an annual wealth tax, a tax on unrealized gains at death, the inclusion of gifts and inheritances in income, and a lifetime accessions tax—and concludes that the last of these options

would serve the primary purpose of a wealth transfer tax more effectively than the others, and would be easier to defend and justify than the existing gift and estate tax system.\textsuperscript{9}

I. WHY TAX WEALTH TRANSFERS?

In order to assess the relative advantages and disadvantages of the current U.S. gift and estate tax and possible alternatives, it is essential to determine the key purpose or purposes that this tax (and wealth transfer taxes more generally) is intended to serve. This Part considers four rationales that are generally advanced: (1) revenue-raising (section A);\textsuperscript{10} (2) distributing the tax burden equitably (section B);\textsuperscript{11} (3) curbing concentrations of wealth (section C);\textsuperscript{12} and (4) regulating intergenerational transfers of wealth (section D).\textsuperscript{13} While the first two rationales were central to the introduction of wealth transfer taxes in the United States and other developed countries, and each of these rationales may have a role to play in defending an existing wealth transfer tax, only the fourth provides a compelling account for a distinct tax on wealth transfers.

A. Raising Revenue

Although it is often recognized that taxes can be imposed for different purposes, including redistribution and regulation in addition to revenue generation,\textsuperscript{14} it is generally assumed that the primary purpose of any tax is to raise revenue. Not surprisingly, raising revenue is often identified as a key purpose of the U.S. gift and estate tax and other taxes on the transfer of wealth.\textsuperscript{15}

Historically, in fact, revenue generation appears to have been a principal reason why governments have introduced wealth transfer taxes. In the United States, wealth transfer taxes of one form or another were enacted in 1797, 1862, and 1898—in each case to finance impending or actual war—and repealed once these revenue needs had passed.\textsuperscript{16} In 1916, the current

\textsuperscript{9} See infra notes 81–108 and accompanying text.
\textsuperscript{10} See infra notes 14–37 and accompanying text.
\textsuperscript{11} See infra notes 38–56 and accompanying text.
\textsuperscript{12} See infra notes 57–67 and accompanying text.
\textsuperscript{13} See infra notes 68–80 and accompanying text.
\textsuperscript{15} See, e.g., Caron, supra note 1, at 824–30 (discussing taxing transfers of wealth at death as a means of raising revenue).
estate tax was introduced to address paramount revenue needs related to World War I.\textsuperscript{17} Revenue considerations were also central to the introduction of a progressive estate duty in the United Kingdom in 1894,\textsuperscript{18} a national estate duty in Australia in 1914,\textsuperscript{19} and a federal succession duty in Canada in 1941.\textsuperscript{20}

Notwithstanding these origins, however, wealth transfer taxes have never played a major role in the revenue systems of these countries, and assumed an increasingly marginal role after World War II as governments in most developed countries turned to income, consumption, and social security taxes as the main sources of tax revenue. Although the ratio of U.S. gift and estate taxes to total federal tax revenues rose from 0.6\% in 1917 to 2.8\% in 1921 and 4.6\% in 1941, this ratio declined to 2.0\% in 1971 and 1.4\% in 2001, and is projected to be only 0.6\% in 2015.\textsuperscript{21} In the United Kingdom, estate tax revenues accounted for 16.1\% of total tax revenues from 1908 to 1915,\textsuperscript{22} but declined to slightly more than 4\% from 1949 to 1965,\textsuperscript{23} between 2.2\% and 2.7\% from 1965 to 1972, and 0.5\% to 0.8\% since 1982.\textsuperscript{24} In Australia, the national estate duty accounted for only 2\% to 4\% of federal tax revenues from 1914 to 1940 and no more than 1.4\% of federal tax revenues after World War II,\textsuperscript{25} whereas federal wealth transfer taxes in Canada never contributed more than 1.7\% of federal tax revenues.\textsuperscript{26} Moreover, among Organisation for Economic Co-Operation and Development (\textquotedblleft OECD\textquotedblright) countries that continue to levy estate, inheritance, or gift taxes, the percentage of total tax revenues these taxes raised ranges from 0.1\% to no more than 1.6\% for the most recent year for which complete statistics are available.\textsuperscript{27}
In contrast to these small percentages, the OECD reports that “income profits and capital gains taxes” generally accounted for between 25% and 60% of total tax revenues in OECD countries in 2012, representing 46.9% of all U.S. taxes, 35.6% of U.K. taxes, 58.1% of Australian taxes, and 47.4% of Canadian taxes. For the same year, general taxes on goods and services typically accounted for 20% to 30% of total tax revenues, though these figures were noticeably lower in the United States (8.2%), which does not levy a federal sales tax, as well as Australia (12.4%) and Canada (14.3%), where value-added taxes are levied at much lower rates than in other OECD countries. Together with social security contributions, which generally account for 20% to 40% of tax revenues in OECD countries, these taxes have become the primary sources of government revenue among developed countries since World War II, greatly eclipsing the role that wealth transfer taxes once played.

For some commentators, the declining role of these taxes as a source of government revenue is a cause for concern, particularly “at a time of acute need for additional federal revenues.” For this reason, one scholar has proposed “restoring the estate tax’s historic role in the federal tax system” in order to increase projected tax revenues over the 2016–25 period from $250 billion to $500 billion to $1 trillion.

Given the structural deficit and increasing federal debt, it is reasonable to expect that revenue considerations will continue to contribute to the argument for retaining the gift and estate tax—particularly given the political resistance to other tax reforms that might increase federal revenues. Nonetheless, there are three reasons why revenue generation should not be regarded as a primary rationale for the existence and design of these taxes.

First, although an original intent of these taxes may have been to raise revenue, this purpose preceded the development of broad-based income, 

\[\text{\footnotesize \textsuperscript{28}} \text{id. (next to “Government” select “Total”; next to “Tax” select “1000 Taxes on income, profits, and capital gains”; change the “Variable” dimension to “Tax revenue as % of total taxation” by clicking “Customize,” then “Selection,” then “Variable,” then check the box next to only “Tax revenue as % of total taxation”). Outliers with less revenue from these sources include the Czech Republic, Estonia, Hungary, Slovakia, and Slovenia.}\]

\[\text{\footnotesize \textsuperscript{29}} \text{id.}\]

\[\text{\footnotesize \textsuperscript{30}} \text{id. (next to “Government” select “Total”; next to “Tax” select “5110 General taxes on goods and services”; change the “Variable” dimension to “Tax revenue as % of total taxation” by clicking “Customize,” then “Selection,” then “Variable,” then check the box next to only “Tax revenue as % of total taxation”).}\]

\[\text{\footnotesize \textsuperscript{31}} \text{id. (next to “Government” select “Total”; next to “Tax” select “2000 Social security contributions (SSC)”; change the “Variable” dimension to “Tax revenue as % of total taxation” by clicking “Customize,” then “Selection,” then “Variable,” then check the box next to only “Tax revenue as % of total taxation”).}\]

\[\text{\footnotesize \textsuperscript{32}} \text{Caron, supra note 1, at 830.}\]

\[\text{\footnotesize \textsuperscript{33}} \text{id.}\]
consumption, and payroll taxes that have proven much more effective (and often more efficient) at raising revenue over the last seventy years. As a result, to rely on this original intent to restore the “historic role” of the U.S. gift and estate tax is to disregard one hundred years of fiscal experience and innovation that recommends other methods of raising revenue.

Second, to make revenue generation a central purpose of a wealth transfer tax may favor certain design features that could contradict the primary contemporary purpose of these taxes: to regulate the intergenerational transfer of wealth in order to reduce inherited concentrations of wealth and power and ensure fair equality of opportunity. To the extent that revenue considerations favor lower thresholds, for example, these taxes may apply more broadly than is necessary to achieve those goals. Revenue objectives may also oppose exemptions for spousal transfers and charitable donations, which are common features of most wealth transfer taxes and broadly compatible with its primary objectives. Indeed, to the extent that a wealth transfer tax reduces the concentration of wealth and encourages a broader distribution of gifts and inheritances in order to benefit from tax-exempt thresholds and lower rates, it is arguable that “the less revenue they raise the more effectively they are achieving their purpose.”

Finally, although there is undoubtedly some truth to the argument that “a tax must have a revenue raising rationale if it is going to endure the changing moods of national social policies,” experience in several developed countries suggests that this rationale is not sufficient to prevent the repeal of wealth transfer taxes given the limited revenue that they are likely to raise compared to other taxes that developed countries have come to rely on over the past century. On the contrary, experience in Canada, Australia, and New Zealand over the past forty years suggests that wealth transfer taxes will become politically vulnerable when the real value of exemptions erodes through inflation and the tax applies more broadly to a larger percentage of the population—as also occurred in the United States from 1951 to 1981 when the exemption remained unchanged at $60,000 and the seeds of the “anti-death tax” movement were sown. As a result, although the current $5 million threshold is probably much higher than would be ideal to properly regulate the intergenerational transfer of wealth, increased thresholds were politically essential to preserve the gift and estate tax, notwithstanding their consequences for raising revenue.

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34 SANDFORD, supra note 22, at 156.
37 GRAETZ & SHAPIRO, supra note 3, at 12–23.
B. Tax Equity

A second rationale for taxing wealth transfers is the role that these taxes may play in the equitable distribution of the overall tax burden. When Congress first passed the estate tax in 1916, for example, the House committee report criticized excessive U.S. reliance on consumption taxes on the grounds that “such taxes bear most heavily upon those least able to pay them”\(^ {38} \)—proposing instead that “[the] revenue system should be more evenly and equitably balanced and a larger portion of our necessary revenues collected from incomes and inheritances of those deriving the most benefit and protection from the Government.”\(^ {39} \) In this way, the committee simultaneously invoked traditional tax equity principles favoring the distribution of taxes according to ability to pay or benefits received.

Although the benefit principle of tax equity has a lengthy history in liberal theory and may usefully support the imposition of specific benefit-related taxes and user fees,\(^ {40} \) it is hopelessly indeterminate as a rationale for any general tax base.\(^ {41} \) Thomas Hobbes, for example, relied on the principle to justify both a head tax and a consumption tax, arguing alternately that equal taxation of the poor and the rich was justified on the basis that both received the same benefit from the commonwealth, namely “the enjoyment of life,” and that the benefits that individuals enjoy under the commonwealth are best measured by what they consume.\(^ {42} \) On the other hand, John Locke appears to have employed the benefit principle to support a tax on personal wealth, whether imposed during the taxpayer’s life or at death, on the grounds that “everyone who enjoys his share of the protection” provided by the state “should pay out of his estate his proportion for the maintenance of it.”\(^ {43} \) In contrast, Adam Smith invoked the same principle as a rationale for income taxation, arguing that “[t]he subject of every state ought to contribute towards the support of the government . . . in proportion to the revenue which they respectively enjoy under the protection of the state.”\(^ {44} \)


\(^{39}\) Id.

\(^{40}\) See, e.g., David G. Duff, Benefit Taxes and User Fees in Theory and Practice, 54 U. TORONTO L.J. 391 (2004) (explaining the theory and practice of benefit taxation, and supporting the use of benefit taxes and user fees as an element of a tax system that also includes redistributive taxes).


Perhaps not surprisingly, therefore, most equity-based arguments for taxing wealth transfers have tended to emphasize taxation according to ability to pay. Within this general framework, moreover, it is possible to discern two alternative equity arguments for taxing wealth transfers: (1) that these taxes contribute to the overall progressivity or vertical equity of the tax system by imposing a larger tax burden on those with a greater ability to pay; and (2) that these taxes contribute to horizontal equity by measuring an ability to pay that is not otherwise recognized by the tax system. Neither approach provides a persuasive rationale for a distinct tax on the transfer of wealth.

1. Vertical Equity

Although wealth transfer taxes may raise relatively little revenue compared to other taxes, they are often defended on the grounds that they contribute to the overall progressivity of the tax system. According to one scholar, for example, “we must look elsewhere than the production of revenues if we are to justify strengthening, rather than eliminating, the estate tax”—emphasizing “its role in the distribution of the tax burden, in particular its role in providing an important element of progressivity in the federal tax system.”45 Others have advanced a similar rationale for the gift and estate tax, arguing that “historic reductions in the progressivity of the tax system” make “revitalization of the estate tax” an essential campaign in “the broader tax reform war.”46

Although initially appealing to anyone who supports progressive taxation, this rationale for taxing wealth transfers is ultimately no more persuasive than the revenue-raising rationale considered earlier. First, the argument is radically incomplete to the extent that it does not itself justify progressive taxation—which is difficult to accomplish under a narrow conception of tax equity as equality of sacrifice, but arguably easier to defend under broader conceptions of distributive justice, which regard progressive

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46 Caron, *supra* note 1, at 836; see also Maureen Maloney, *Distributive Justice: That Is the Wealth Tax Issue*, 20 OTTAWA L. REV. 601, 611 (1988) (“The most powerful arguments in favour of some type of wealth taxation are based on ensuring progressivity and enhancing equality of opportunity objectives in the Canadian tax system.”).
47 Although it is often assumed that a diminishing marginal utility of income or wealth favors progressive taxation in order to equalize the absolute burden or dissuity of taxation among differently situated taxpayers, this is true only where the percentage reduction in the utility of income or wealth is greater than the percentage increase in income or wealth. See A.C. Pigou, *A Study in Public Finance* 85–86 (3d rev. ed. 1947) (noting that the “law of diminishing utility” establishes only that “the last £1 of a £1000 income carries less satisfaction than the last £1 of a £100 income does,” whereas progressivity requires that “the last £10 of a £1000 income carry less satisfaction than the last £1 of a £100 income,” which “the law of diminishing utility does not assert”). For an excellent discussion of equal sacrifice theories of tax equity, see Walter J. Blum & Harry Kalven, Jr., *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417, 455–61 (1952).
taxes as a kind of premium to insure against the risk of economic disadvantage. \(^{48}\) Second, because this rationale depends on the tax raising a meaningful quantity of revenue to contribute to the overall progressivity of the tax burden, it is subject to the same objections against the revenue-raising rationale outlined earlier. Third, the contribution of the gift and estate tax to the overall progressivity of the tax system is generally assumed, rather than proven, without explaining the incidence of these taxes, nor the criterion by which this progressivity is measured. \(^{49}\) Fourth, assuming that the gift and estate tax contributes to the overall progressivity of the tax system, it is not obvious that this contribution is preferable to other measures that could enhance progressivity more directly, such as income tax base broadening and rate increases. \(^{50}\) Nor is it obvious that the redistributive goals underlying many arguments for tax progressivity are best achieved by the tax system alone, without regard to government expenditures that generally have a greater distributional impact than the distribution of tax burdens. \(^{51}\) For all these reasons, vertical equity or progressivity seems like an uncertain foundation on which to construct a solid defense of a wealth transfer tax.

2. Horizontal Equity

An alternative equity-based rationale for the taxation of wealth transfers emphasizes the role of wealth as a measure of ability to pay that is not otherwise recognized in the tax system, but ought to be if taxes are to be equitably distributed among taxpayers with the same ability to pay. According to one version of this argument, because income taxes generally exclude imputed income from property and usually apply to gains only when they are realized, 


\(^{49}\) Michael Graetz, for example, uses a crude methodology, comparing revenues from the gift and estate tax to revenues from income taxes above the average rate. See Graetz, supra note 45, at 272. For a more sophisticated approach, which assumes that the gift and estate tax is borne primarily by heirs and measures the distributional impact of the tax according to their economic income, see Batchelder, supra note 7, at 5–44. See also Thomas Piketty & Emmanuel Saez, How Progressive Is the U.S. Federal Tax System? A Historical and International Perspective, 21 J. ECON. PERSP. 3, 3 (2007) (analyzing the progressivity of the U.S. tax system using tax return data).

\(^{50}\) Although it is often argued that wealth transfer taxes affect incentives to work and save less than income taxes of equal yield, the incentive effects of these taxes continue to be studied and debated. As a result, while a growing consensus appears to conclude that these incentive effects are not significant, economic analysis does not provide an obvious argument to prefer the taxation of wealth transfers to the taxation of high incomes earners. For a survey of recent studies, on the economic effects of the gift and estate tax, see Wojciech Kopczuk, Economics of Estate Taxation: Review of Theory and Evidence, 63 TAX L. REV. 139 (2009).

wealth taxation merits serious consideration as a complement or alternative to the taxation of income. As well, to the extent that wealth affords advantages of “opportunity, flexibility and security” beyond the income that it may generate, it is sometimes argued that these advantages should also be taken into account in computing a taxpayer’s ability to pay. From this perspective, as a report of a committee of the Institute for Fiscal Studies concluded in 1978, “a tax on the transfer of inherited wealth as it passes down from parent to child” might be justified as “in effect a periodic charge, levied once a generation, on the holding of such wealth.”

Whatever the merits of these horizontal equity arguments may be as rationales for the periodic taxation of wealth, they are deficient as justifications for the taxation of wealth transfers. First, because wealth transfer taxes exclude all accumulated wealth that is consumed before death, they are—as one commentator has aptly observed—“at best crude once-a-generation approximations” to periodic taxes on wealth. Second, the dynastic conception of the tax unit that is implicit in this justification for wealth transfer taxation contradicts the liberal emphasis on individual rights and responsibilities that underlies the most persuasive justification for wealth transfer taxes to minimize unearned advantages from substantial inheritances and ensure fair equality of opportunity. For these reasons, horizontal equity is no more persuasive than vertical equity as a rationale for the taxation of wealth transfers.


53 Richard M. Bird, The Case for Taxing Personal Wealth, in CAN. TAX FOUND., REPORT OF THE PROCEEDINGS OF THE TWENTY-THIRD TAX CONFERENCE 6, 8 (1972); see also James Cutt, A Net Wealth Tax for Canada?, 17 CAN. TAX J. 298, 304 (1969) (“The argument that a wealth tax is inequitable in that property may not directly yield money income merely serves to emphasize the inadequacy of the definition of income used in computing economic well-being and consequent ability to pay taxes.”).


55 To the extent that wealth represents deferred consumption in the form of lifetime savings, it is arguable that any additional ability to pay that is attributable to wealth at any particular time does not confer any greater ability to pay over the course of a lifetime, calling into question horizontal equity arguments for taxing personal wealth. For a critical evaluation of wealth taxation from the perspective of distributive justice, see Eric Rakowski, Can Wealth Taxes Be Justified?, 53 TAX L. REV. 263 (2000).

C. Curbing Concentrations of Wealth

A third rationale for taxing wealth transfers is to curb extreme concentrations of wealth, which can threaten democratic institutions, social stability, and economic growth and prosperity. As Rawls observes, “when inequalities of wealth exceed a certain limit,” democratic institutions are “put in jeopardy,” “political liberty likewise tends to lose its value, and representative government . . . become[s] such in appearance only.” In addition, a growing body of empirical literature suggests that extreme inequalities undermine social stability and impede economic growth and prosperity by reducing aggregate demand for goods and services and lessening productivity-enhancing investments in education and public infrastructure.

As certain scholars have documented, after decreasing steadily from 1929 to 1978, the concentration of wealth at the very top of the U.S. wealth distribution increased sharply from 1978 to 2012; the share of wealth held by the top 1% of households rose from approximately 23% to 41.8%, the share of wealth held by the top 0.1% of households increased from 7% to 22%, and the share of wealth held by the top 0.01% of households increased from roughly 2.2% to 11.2% (which is higher than it was in the 1920s). Studies also suggest that inherited wealth accounts for a substantial share of overall wealth, and that wealth transfer taxes can contribute to reductions in the concentration of wealth.

For these reasons, it is not surprising that a

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57 See Caron, supra note 1, at 837–42.
58 RAWLS, supra note 8, at 278.
61 See, e.g., Henry J. Aaron & Alicia Munnell, Reassessing the Role for Wealth Transfer Taxes, 45 NAT’L TAX J. 119, 131 (1992) (concluding that up to 52% of wealth is inherited); William G. Gale & John Karl Scholz, Intergenerational Transfers and the Accumulation of Wealth, 8 J. ECON. PERSP. 145, 154 (1994) (concluding that intergenerational transfers account for 51% of wealth).
62 See, e.g., A.B. ATKINSON & A.J. HARRISON, DISTRIBUTION OF PERSONAL WEALTH IN BRITAIN (1978) (concluding that wealth transfer taxes may have contributed to reduced wealth inequality in Great Britain over the course of the twentieth century); Paul L. Caron & James R. Repetti, The Estate Tax Non-Gap: Why Repeal a “Voluntary” Tax?, 20 STAN. L. & POL’Y REV. 153, 159–62 (2009) (concluding that the U.S. gift and estate tax has contributed to the diminution
prominent rationale for the taxation of wealth transfers is to decrease wealth inequalities by curbing concentrations of wealth.

Although this rationale is more persuasive than revenue-raising and tax-equity arguments for wealth transfer taxes, it is incomplete for two reasons. First, to the extent that economic inequality is, as recent studies suggest, much more attributable to disparities in labor income that it is to inequalities in capital income, it is not clear why a wealth transfer tax that addresses only one cause of this inequality should be favored over other measures aimed at these other causes of economic inequality. More generally, if the only objective of the tax is to curb concentrations of wealth irrespective of their cause, it is not clear why a wealth transfer tax is preferable to a periodic or extraordinary wealth tax that could target wealth inequality directly. Indeed, one scholar has proposed an annual wealth tax, rather than a wealth transfer tax, as a key response to increasing wealth inequality.

Although one might fall back on a wealth transfer tax as an administratively simpler alternative to an annual wealth tax, which faces formidable challenges of valuation, this response is unsatisfactory to the extent that it depends on the assumption that all wealth, however derived, is a legitimate source for redistributive taxation—an assumption that at least some advocates of wealth transfer taxation have questioned. Instead, as the following section argues, the unique virtue of a wealth transfer tax is to target unearned sources of wealth that not only contribute to wealth inequality, but do so in a way that perpetuates dynastic concentrations of wealth and power and undermine fair equality of opportunity.

D. Regulating the Intergenerational Transmission of Wealth

Although extreme inequalities in the distribution of wealth are themselves detrimental to democracy, social stability, and economic growth, extreme inequalities in the distribution of inherited wealth are a much greater concern—perpetuating political and economic power from one generation to the next, undermining fair equality of opportunity, and allowing distrib-

66 See Rakowski, supra note 55 (evaluating wealth taxation from the perspective of distributive justice).
67 See infra notes 68–80 and accompanying text.
tive outcomes to be substantially influenced by the intergenerational transmission of vast fortunes that are essentially unearned by their recipients.

Beginning with political power, it is often remarked that dynastic concentrations of wealth pose a much greater threat to democratic institutions than concentrations of wealth that are confined within a single generation. As Alexis de Tocqueville famously wrote: “What is most important for democracy is not that great fortunes should not exist, but that great fortunes should not remain in the same hands.” For this reason, as the Ontario Committee on Taxation concluded in 1967, taxes on the transfer of wealth are “an essential safeguard to the fabric of a democratic society”—controlling “the growth . . . of an economically powerful minority whose influence is based on inherited wealth.”

Likewise with economic power, it is often noted that the intergenerational transmission of assets and enterprises can impede economic growth and efficiency by preventing the transfer of assets to their most highly valued uses, depriving enterprises of more talented managers, and discouraging work effort on the part of heirs. At the same time, although critics insist that wealth transfer taxes discourage capital accumulation and discourage economic growth, empirical studies suggest that wealth transfer taxes have relatively little impact on the magnitude of wealth transfers—a finding that is consistent with theoretical analysis suggesting that the motives for leaving a bequest are mixed, including accidental bequests on which wealth transfer taxes have no impact and altruistic bequests for which wealth transfer taxes

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70 See, e.g., SANDFORD, supra note 18, at 38–39 (providing an example of such through discussing the history of the British death duty); Bird, supra note 53, at 20.

71 See, e.g., C.T. SANDFORD ET AL., AN ACCESSIONS TAX 137–42 (1973) (examining the consequences of a replacement of the estate duty in the United Kingdom with a cumulative tax on gift and inheritance recipients).

72 See, e.g., SHOUP, supra note 54, at 89 (discussing the effect on heirs); Bird, supra note 53, at 17–18 (providing an example of this in a discussion on Canadian estate tax).

73 See, e.g., Edward J. McCaffery, The Uneasy Case for Wealth Transfer Taxation, 104 YALE L.J. 283, 289–97 (1994) (providing the liberal egalitarian viewpoint that both supports and rejects taxation of wealth transfer); David A. Ward, The Case Against Capital Taxes, 2 CAN. TAX’N 31 (1980) (arguing that further taxation of wealth will have a “probably detrimental effect on the Canadian economy”).

can encourage increased saving in order to maintain a targeted bequest after tax.\textsuperscript{75} As a result, the inheritance of economic power may be even more detrimental to economic growth and efficiency than the concentration of economic power within a single generation.

In addition to these political and economic concerns, the intergenerational transmission of substantial fortunes contradicts basic principles of fair equality of opportunity and equal concern for all citizens that are central to liberal conceptions of distributive justice.\textsuperscript{76} As Rawls explains, fair equality of opportunity is essential to a conception of distributive justice in which social and economic inequalities are justified on the basis that they are reasonably expected to contribute to everyone’s advantage.\textsuperscript{77} For this reason, he maintains, progressive gift and inheritance taxes are necessary “not to raise revenue . . . but gradually and continually to correct the distribution of wealth and to prevent concentrations of power detrimental to the fair value of political liberty and fair equality of opportunity.”\textsuperscript{78} Similarly, Ronald Dworkin concludes that “it is unjust” for a political community that regards its citizens with equal concern to allow some people to “lead their lives with less wealth available to them . . . than others, not through some choice or gamble of their own but through brute bad luck.”\textsuperscript{79} For this reason, he also advocates “an inheritance tax, at a steeply progressive rate” in order to moderate inequalities in the intergenerational transmission of wealth—suggesting that revenues from this tax should be devoted to “improved public education, education and training loans for would-be professionals, and other programs that ease the impact of whatever economic stratification remains after the tax has been levied.”\textsuperscript{80} In addition to concerns about intergenerational transmission of political and economic power, these theories of distributive justice support a distinct tax on the transfer of inherited wealth in order to reduce unearned concentrations of wealth and power and ensure fair equality of opportunity.

\textsuperscript{75} For an excellent summary of this literature, see Batchelder, \textit{supra} note 7, at 36–38 (concluding on the basis of existing literature that roughly 50\% of wealth transfers are accidental and approximately 20\% altruistic).


\textsuperscript{77} \textit{RAWLS, supra} note 8, at 73, 83–90.

\textsuperscript{78} \textit{Id.} at 277.

\textsuperscript{79} \textit{DWORKIN, supra} note 48, at 347.

\textsuperscript{80} \textit{Id.} at 349.
II. ALTERNATIVES TO THE GIFT AND ESTATE TAX

If the primary purpose of a tax on the transfer of wealth is to regulate the intergenerational transmission of substantial fortunes in order to reduce unearned concentrations of wealth and power and ensure fair equality of opportunity, the current gift and estate tax is deficient, because it applies to donors rather than recipients of inherited wealth, and varies according to the aggregate value of a donor’s inter vivos gifts and bequests rather than the amounts that individual beneficiaries receive. For these reasons, the gift and estate tax is also vulnerable to the criticism that it constitutes a “double tax” on thrifty and hardworking individuals who manage to accumulate wealth during their lifetimes.81

Instead of defending the current tax, therefore, it may be more useful to consider alternative approaches that might better serve the primary purpose of a wealth transfer tax and may, for this reason, be easier to justify and defend. This Part considers the four most prominent alternatives to the current gift and estate tax: (1) an annual wealth tax (section A);82 (2) taxing unrealized gains when property is transferred by gift or at death (section B);83 (3) including gifts and inheritances in the recipient’s income (section C);84 and (4) a lifetime accessions tax (section D).85 It concludes that the last of these approaches best fulfills the purpose of a wealth transfer tax to regulate the intergenerational transmission of substantial fortunes and is more likely to attract political support than the current tax.

A. Annual Wealth Tax

As explained earlier, supporters of a periodic or annual tax on net wealth often do so because it would recognize a form of ability to pay that is not otherwise taken into account under a realization-based income tax.86 Others advocate periodic wealth taxes on explicitly redistributive grounds as a response to increasing wealth inequality.87 As an alternative to the current gift and estate tax, some might also favor an annual wealth tax on the grounds that a low-rate tax levied on a recurring basis might be less susceptible to avoidance and tax planning than a much higher-rate tax that is imposed mainly at death.

82 See infra notes 86–88 and accompanying text.
83 See infra notes 89–97 and accompanying text.
84 See infra notes 98–104 and accompanying text.
85 See infra notes 105–108 and accompanying text.
86 Supra notes 52–53 and accompanying text.
87 See, e.g., PIKETTY, supra note 64, at 471–539.
Whatever the merits of these arguments, a periodic tax on net wealth is a poor substitute for a wealth transfer tax that is designed to reduce unearned concentrations of wealth and power and ensure fair equality of opportunity—because it applies to all wealth, whether earned or unearned, and does not distinguish between inherited wealth that contributes to unequal opportunities, and accumulated wealth that may result from prior decisions to work and to save. Indeed, to the extent that a periodic wealth tax imposes an additional burden on income that is earned and saved, it is as vulnerable as the current gift and estate tax to the criticism that it results in double taxation, and is arguably more difficult to justify than a wealth transfer tax that applies only to the fortunate recipients of substantial inheritances. As a practical matter, moreover, annual wealth taxes also face formidable challenges of valuation, making them more difficult and costly to administer than taxes on the transfer of wealth, when valuations are often required for estate administration purposes. For all these reasons, an annual wealth tax would be an unsatisfactory alternative to the gift and estate tax.

B. Taxing Unrealized Gains

Another alternative to the gift and estate tax might be to repeal the carryover basis rule in § 1015 of the Internal Revenue Code (“I.R.C.”) and the stepped-up basis rule in § 1014, and instead tax unrealized gains when property is transferred by gift or at death. Widely regarded as a useful reform to improve the equity and efficiency of the income tax by preventing the unlimited deferral and exemption of unrealized gains, this approach has also been proposed as a way to maintain at least some of the goals of the gift and estate tax if these taxes are repealed—potentially recouping “all or a major portion of the revenue lost under transfer tax repeal,” achieving

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88 Compare Rakowski, supra note 55 (objecting to an annual wealth tax on the grounds of justice), with Rakowski, supra note 76 (supporting a wealth transfer tax on the grounds of justice).


a similar degree of progressivity in the distribution of the tax burden,\textsuperscript{92} and also “curbing undue accumulations of wealth.”\textsuperscript{93} In addition, to the extent that taxing both gifts and estates and unrealized gains on the transfer of property is regarded as inappropriate double taxation,\textsuperscript{94} replacing an unpopular gift and estate tax with a deemed realization approach might be regarded as an acceptable tradeoff to improve the overall tax system. In Canada, for example, the federal government opted to repeal its gift and estate tax when it introduced a tax on capital gains that included a deemed realization on transfers of property by gift or at death.\textsuperscript{95}

Notwithstanding its merits for the purpose of the income tax, there are three reasons why a deemed realization approach is unsuitable as an alternative to the gift and estate tax or an effective tax on the transfer of wealth. First, although studies suggest that unrealized gains represent a significant share of estate values, which increases as the value of the estate increases,\textsuperscript{96} a tax on unrealized gains necessarily applies only to a fraction of all wealth transfers, and this portion could be expected to decrease with a deemed realization rule under which the incentive to hold appreciated property until death would diminish. Second, although a tax on unrealized gains could raise more revenue than the gift and estate tax if it were applied to all or most gains without any exemption,\textsuperscript{97} this approach would shift the overall distribution of the tax toward smaller estates and away from the largest estates, reducing both its progressivity and its effectiveness to limit concentrations of inherited wealth. Finally, because a tax on unrealized gains applies

\textsuperscript{92} Id. at 476.

\textsuperscript{93} Id. at 529.


\textsuperscript{95} Duff, supra note 4, at 89–107. For some commentators, this decision demonstrates that it is politically impossible simultaneously to levy a wealth transfer tax and tax unrealized gains at death. See, e.g., Wolfe Goodman, The End of the Canadian Estate Tax—A Lesson for the U.S., 84 TAX NOTES 1469 (1999) (discussing the politics and reasoning behind Canada’s repeal of the estate tax). In fact, the abolition of wealth transfer taxes in Canada is much more complicated and had as much to do with federal-provincial revenue arrangements as with the introduction of capital gains tax. As a result, the Canadian experience should not necessarily be read to exclude the possibility of taxing unrealized gains at death as well as transfers of wealth—particularly if, as proposed below, the wealth transfer tax applies to amounts received by beneficiaries rather than the gross value of a decedent’s estate.

\textsuperscript{96} See, e.g., James M. Poterba & Scott Weisbenner, The Distributional Burden of Taxing Estates and Unrealized Capital Gains at Death, in RETHINKING ESTATE AND GIFT TAXATION, supra note 74, at 422, 439 (reporting that unrealized gains represented approximately 36% of the aggregate value of all estates in 1998, and 56% of the value of estates worth at least $10 million); Wilbur A. Steger & Frederick H. Rueter, The Revenue Effects of Estate Tax Repeal and Basis Step-up Limits, 107 TAX NOTES 1314, 1315 (2005) (reporting that unrealized gains represent at least 70% of the value of large estates).

\textsuperscript{97} Where a deemed realization approach is intended to complete the income tax, any exemption would be unwarranted. Dodge, supra note 90, at 1855–56.
to donors of wealth rather than recipients and is based on the circumstances of donors rather than amounts received by recipients, it suffers from the same deficiency as the gift and estate tax as a method of regulating intergenerational transfers of wealth. As a result, although a tax on unrealized gains would be a significant improvement for the income tax, it would be a poor substitute for a tax on the transfer of wealth.

C. Taxing Gifts and Inheritances as Income

A third alternative to the gift and estate tax would be to repeal § 102 of the I.R.C. and include gifts and inheritance as income of recipients.98 Widely regarded as essential to the design of a comprehensive income tax,99 the inclusion of gifts and inheritances in income would represent a significant improvement on the gift and estate tax, because the tax would apply to recipients of inherited wealth rather than donors, and vary according to the economic circumstances of recipients rather than amounts transferred by donors.100 To the extent that income inclusion encourages donors to direct gifts and bequests to less affluent recipients, this approach might also help reduce concentrations of wealth.101

Despite these advantages over a donor-based tax, an income-inclusion approach suffers from three major deficiencies as a tax on the transfer of wealth. First, an income-inclusion approach would—at least in principle—subject all gifts and inheritances to tax, which is unnecessary to achieve the primary objective of a wealth transfer tax to regulate the intergenerational transmission of wealth. For this reason, many income-inclusion proposals have annual exclusions and lifetime thresholds, which cause the income-inclusion approach to resemble a lifetime accessions tax.102 Second, the rate at which an income-inclusion approach applies to gifts and inheritances would be determined by the recipient’s marginal rate in the year in which amounts are received, which is generally less than necessary to properly regulate the intergenerational transmission of wealth, but could also be excessive where a substantial transfer received in one year causes the recipient to pay tax at a higher marginal rate than would apply if the transfer were spread out over several years. For this reason, income-inclusion proposals generally include a supplementary tax on gratuitous transfers above a threshold, as well as averaging provisions to prevent the bunching of gifts

99 3 ROYAL COMM’N ON TAXATION, supra note 6, at 41; SIMONS, supra note 5, at 126; Dodge, supra note 7, at 1179–82.
100 Batchelder, supra note 7, at 67–73.
101 Id. at 73–74.
102 See, e.g., id. at 59–67 (outlining administrative restraints on an ideal wealth transfer tax system and proposing a comprehensive inheritance tax).
and inheritances in a single taxation year—which again make them resemble a lifetime accessions tax.\footnote{See, e.g., id. (outlining administrative restraints on an ideal wealth transfer tax system and proposing a comprehensive inheritance tax).} Finally, where gifts and inheritances are characterized as income, it might be argued that donors should obtain a deduction for amounts transferred, and that the failure to grant such a deduction amounts to double taxation.\footnote{Burke & McCouch, supra note 94, at 547–53.} For all these reasons, an income-inclusion approach is both deficient as a wealth transfer tax and an unlikely alternative to the gift and estate tax.

**D. Lifetime Accessions Tax**

Although an income-inclusion approach may be deficient as a wealth transfer tax, it points toward a more attractive alternative to the gift and estate tax—a lifetime accessions tax that would tax recipients of inherited wealth on the cumulative value of gifts and inheritances received over the course of their lifetimes. Like the income-inclusion approach, a lifetime accessions tax would be based on the circumstances of recipients rather than donors, and would encourage donors to distribute gifts and bequests more widely—serving the primary purpose of a wealth transfer tax to reduce concentrations of inherited wealth. Unlike the income-inclusion approach, a lifetime accessions tax would distinguish between earned income subject to the income tax, and unearned gifts and inheritances subject to a separate tax that is specifically designed to regulate the intergenerational transmission of wealth—thereby reducing the concentration of inherited wealth and power and ensuring fair equality of opportunity. For these reasons, a lifetime accessions tax should be easier to defend as a tax on the fortunate beneficiaries of substantial gifts and inheritances, rather than a tax on thrifty and hardworking donors, and less vulnerable to the criticism that it amounts to double taxation.\footnote{GRAETZ & SHAPIRO, supra note 3, at 235.} It might also be easier to combine such a tax with a deemed realization of gains on property that is transferred by gift or at death, because a tax on unrealized gains would apply to donors as part of the income tax, whereas a lifetime accessions tax would apply to net after-tax amounts received in the form of gifts and inheritances.\footnote{See, e.g., Laura E. Cunningham & Noël B. Cunningham, Commentary, Realization of Gains Under the Comprehensive Inheritance Tax, 63 TAX L. REV. 271 (2009) (discussing the coupling of comprehensive income taxation with “a rule that taxes gratuitous transfers as realization events, resulting in inclusion of the appreciation in the income tax base of the donor/decedent”).}

Although this Article cannot address the design of such a tax in detail, key features would include: (1) an annual exclusion designed to exempt
reasonable gifts and support obligations; (2) a lifetime threshold designed to limit the tax to transfers of substantial amounts; (3) exemptions for transfers to spouses and charities, and; (4) progressive rates that might reasonably increase to a rate significantly higher than the top marginal income tax rate.\textsuperscript{107} In addition, given the purpose of the tax to reduce concentrations of inherited wealth and power and ensure fair equality of opportunity, revenues might reasonably be dedicated toward education and training programs designed to promote opportunities and reduce economic stratification.\textsuperscript{108}

CONCLUSION

Although the gift and estate tax may have survived its near-death experience in 2010, it remains deeply unpopular and politically vulnerable. This condition is partly attributable to an extended campaign that “anti-death tax” advocates have waged against the tax over the past two decades,\textsuperscript{109} but is also attributable to the form of the tax, which applies to donors rather than recipients and is therefore easily characterized as an unfair double tax on thrifty and hardworking donors, rather than a tax on unearned gifts and inheritances that perpetuates dynastic concentrations of wealth and power and undermines fair equality of opportunity. In contrast, a lifetime accessions tax best serves the primary purpose of a wealth transfer tax to reduce the concentration of inherited wealth and power and ensure fair equality of opportunity, and is more likely to attract the kind of political and popular support that will enable a federal wealth transfer tax to survive another hundred years.

\textsuperscript{107} For detailed treatments of essential issues in the design of a lifetime accessions tax, see Alstott, supra note 76, at 501–42 (detailing important considerations when creating an “equal opportunity inheritance tax”); Joseph M. Dodge, Replacing the Estate Tax with a Reimagined Accessions Tax, 60 HASTINGS L.J. 997, 1014–61 (2009) (examining the “principal issues relating to the accessions tax base”); Miranda Perry Fleischer, Divide and Conquer: Using an Accessions Tax to Combat Dynastic Wealth Transfers, 57 B.C. L. REV. 913 (2016) (working out important design issues that arise when creating an accessions tax).

\textsuperscript{108} DWORKIN, supra note 48, at 349. As an alternative to publicly funded programs, one might also imagine a “social inheritance” in which all individuals would receive a fixed sum upon reaching the age of maturity. BRUCE ACKERMAN & ANNE ALSTOTT, THE STAKEHOLDER SOCIETY (1999).

\textsuperscript{109} GRAETZ & SHAPIRO, supra note 3.